

Message Text

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ACTION EB-07

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FM AMCONSUL HONG KONG

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TAGS: EFIN, ETRD, ECON HK

SUBJECT: DECLINE IN U.S. DOLLAR PARITY CAUSES CONCERN AMONG H.K.
EXPORTERS, PROMPTS PRIME RATE REDUCTION

1. THE CONTINUOUS DECLINE IN THE VALUE OF THE U.S. DOLLAR FROM HK
\$5.060 IN DECEMBER, 1975, TO HK\$4.6150 ON JANUARY 4, 1977, (8.79PCT)
IS CAUSING CONSTERNATION AMONG HONG KONG BUSINESS CIRCLES NOT ONLY
BECAUSE OF THE PREEMINENCE OF THE FOREIGN TRADE COMPONENT OF THE
ECONOMY, BUT ALSO BECAUSE OF THE IMPORTANCE OF THE US AS HONG KONG'S
MAJOR MARKET.

2. LOCAL EXPORTERS ARE, OF COURSE, DISADVANTAGED IN TWO WAYS. THE
IMMEDIATE IMPACT IS A SIGNIFICANT REDUCTION OF PROFITS AS CONTRACTS
ARE NORMALLY DENOMINATED IN U.S. DOLLARS. THE LONGER TERM EFFECT
FEARED BY THE WIDER BUSINESS COMMUNITY IS A LOSS OF COMPETITIVENESS
RESULTING FROM THE NEED TO QUOTE HIGHER PRICES IN TERMS OF U.S.
DOLLARS. FOR EXAMPLE, SOME EXPORTERS HAVE SAID THEY WILL NOW TRY TO
FIX FUTURE PRICES ON THE BASIS OF THE US\$1 EQU HK\$ 4.50 - AN
INCREASE OF 11 PCT OVER THE OLD RATE OF US\$1 EQV HK\$5.00.

3. THERE IS MUCH LOCAL SPECULATION OVER THE CAUSES OF THE
PRECIPITOUS DECLINE. SOME OF THE MORE OBVIOUS CULPRITS ARE

A) THE DECLINE IN INTEREST RATES IN THE U.S. B) THE LARGE

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MULTILATERAL TRADE DEFICIT OF THE US IN 1976 AND PROSPECTIVE
DEFICIT IN 1977.) C) THE APPROACH OF THE CHINESE NEW YEAR,
CAUSING LOCAL RESIDENTS TO CASH FOREIGN ASSETS TO PAY LOCAL
DEBTS. D) THE ABSENCE OF LARGE PRC PURCHASES OF US DOLLARS.
E) HONG KONG'S LARGE BILATERAL TRADE SURPLUS WITH THE US FOR
1976. F) EXPECTED EXPANSIONARY FISCAL ACTIONS BY THE NEW
ADMINISTRATION.

4. MAJOR HK BANKS (HK & SHANGHAI, CHARTERED) 6 JANUARY LOWERED THEIR PRIME LENDING RATES FROM 6.0PCT TO 5.5PCT, EFFECTIVE JANUARY 6. WORD OF BANKS' DECISION TEMPORARILY AFFECTED FOREIGN EXCHANGE RATES, RAISING HK-US DOLLAR RATE FROM \$4.615 TO \$4.66. GENERAL MANAGER OF HK & SHANGHAI BANK, CURRENTLY CHAIRMAN OF EXCHANGE BANKS ASSOCIATION, CLAIMED THAT BANKS LOWERED INTEREST RATES FOR TWO CHIEF REASONS: 1) TO HALT THE SPEED AT WHICH THE HK DOLLAR HAD BEEN APPRECIATING AGAINST THE US DOLLAR IN RECENT WEEKS (THE FOCUS OF EXPORTERS' CONCERNS); 2) TO BRING HK INTEREST RATES INTO LINE WITH LOWER US PRIME RATES AND LOWER EURODOLLAR RATES. BANKERS' CONSENSUS, REPORTED IN ENGLISH-LANGUAGE PRESS, IS THAT LOWER INTEREST RATES WOULD PROP UP US DOLLAR EXCHANGE RATE ONLY TEMPORARILY AND THAT FURTHER DECLINES - PERHAPS TO HK\$4.50 - WERE IMMINENT.

5. ALTHOUGH THERE ARE OBVIOUSLY MANY FACTORS INFLUENCING EXCHANGE RATE MOVEMENTS, WE BELIEVE THE UNDERLYING CAUSE IS THE RELATIVELY LOW RATE OF INFLATION IN HONG KONG OVER THE PAST TWO AND A HALF YEARS. THIS HAS RESULTED IN AN UNDERVALUED HONG KONG DOLLAR WHICH IS PROBABLY NOW IN THE PROCESS OF CORRECTION THROUGH MARKET FORCES.
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